

POLITICAL RISK AND TURKEY 2002-2019

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Abstract

Political risk has become a common topic in recent years. Political risk, which is considered as the main parameter of country risk by international rating agencies, affects CDS credit scores and foreign investor decisions, which are very important in international trade. This study aimed to investigate the factors that make up Turkey as an example of political risk. Accordingly, the situations involving the political risk and the effects of the country in the period after the 2001 financial crisis were analyzed. Examples of political content and measure the risk scoring system used in the PRS Group research company, including risks related to the methods and principles taken from the 2001-2019 year, Turkey was subjected to analysis with this data. Besides scores of different international rating agencies it is made by comparing a general assessment about Turkey. It was determined that the political risk damaged the country's economy, growth, investment and future. In order to reduce the perceived political risk in the international system of Turkey, emphasized the necessity of the factors affecting ratings are given.

Keywords: Political Risk, FDI, Country Risk, Credit Rating

1. Introduction

The importance of the analysis of the risks in the countries invested increases with the increase of international trade and therefore foreign investments. Country risk analyzes are the ratings by which political risks and economic risks are measured and scored, and that measurement companies calculate using different percentages. Political risk is analyzed under country risk calculation.

Political risk is a type of risk faced by investors, companies and governments, where political decisions, events or circumstances will significantly affect the profitability of a business actor or the expected value of an economic action. In other words, it is defined as the political damage that a business and its operations will suffer due to political behavior. In addition, if the political risk is not noticed, the enterprise will suffer much more than this. Risk is often measured as the probability of occurrence of a loss or negative impact (Aydın, 2013). The main point here is to make a profit by paying the price within the framework of the measurability and predictability of the risk.

Therefore, political risk affects CDS (Credit Default Swap) risk premiums in international trade and the decision of the country to transfer the investor's money. CDS is the price for a person or organization to agree to assume the risk of non-payment of the credit that the lender may face. In this context, it works in a sense like credit insurance. This study includes Turkey's, which is an emerging economy, situation is illustrated by the political risks discussed until 2019 after the 2001 financial crisis and explained by examples.

2. Political Risk Concept

Political risk is the threat of social, political or economic factors in a foreign country that can affect the feasibility and profitability of an organization's global operations. Political risk is the changes in the operating conditions that will affect the ownership rights and corporate behavior of foreign investors, such as war, riot, political violence, and corporate behavior due to a political development (Lax, 1982). When the determinants of the political risk are analyzed for democratic countries, elections and the conflicts between political parties and the power holding groups issues stand out, even if the process is democratic çıkabilir (Phillips, 2006).

Political risk sources include frequent or unexpected government changes, changes in government policies, economic instability, nationalization, privatization, civil unrest, corruption or lack of infrastructure (Minor, 2003).

Political risk assessment refers to the risk that a government action will negatively affect the cash flows of international investors and is one of the most important factors underlying foreign direct investment (FDI) decisions. This framework definition - whose features are discussed - covers political actions that vary depending on location and period.

In the study in which Clare and Gang (2009) examined the relationship between foreign direct investments (FDI), exchange rate risk and political risk, between 1999-2003, the exchange rate risk was analyzed for all developed and developing countries using data for 53 countries. In panel data analysis, it was observed that it had a significant and negative effect on foreign direct investment. In addition, it has been established that political stability has a positive impact on FDI, but it is only important for developing countries. In their work, they reached similar results: Clare (1992), Benassy-Quere, Fontagne, and Lahreche-Revil (2001), and Brzozowski (2006).

When it is searched for studies related to Turkey (Emir, Uysal, & Doğru, 2013) , one example is about the relations between foreign direct investment, country risk and macroeconomic variables. For the data period 1992: 1-2010: 4 they used, direct foreign investment and country risk, openness rate, foreign trade deficit, gross domestic product, political risk and real exchange rate. Johansen co-integration analysis and error correction model were used to determine the relationship between the variables. As a result of the analysis, it was determined that FDI was positively affected by GDP and country risk. On the other hand, FDI is negatively affected by the variables of political risk and foreign trade deficit. Econometric findings reveal a one-way causality relationship between FDI and political risk and country risk rating.

In another study the impact on FDI of CDS risk premia have been examined again via Turkey (Barut, 2019) by using data from 2000 to 2019 with time series analysis. It has been demonstrated that the results of the research showed especilly after 2000s, investors who invest in Turkey, taking CDS (Credit Default Swap) risk premiums into account. Accordingly, as CDS risk premium increases, capital inflows decrease, and when CDS risk premiums decrease, it is observed that capital inflows increase. There is an inverse proportional relationship between the two variables.

FDI, as in most countries is also closely related to Turkey's economy. Republic of Turkey, the current geopolitical situation, because of its proximity to the border regions of neighboring problematic issues and political risk assessment is in a disadvantageous position. Even if it narrows the risk in its domestic politics, it can be negatively affected by the international environment and the situation of its neighboring countries. Not only the neighboring countries but also the problems experienced by the actors in the international arena affect the country. This condition is described as Volality, Turkey as it is in all developing countries are exposed to the external impacts be felt heavily.

3. Measurement of Political Risk

Today, measuring of the political risk is very important both to have information about a country's past and to create a future forecast. International companies or institutions need these analyzes to plan or organize their future activities.

There are a wide variety of political risk determinants and measurement methods. However, accurate measurement involves empirical difficulties. Because in order to prevent possible losses, the risk indicators related to the host country should include macroeconomic, political and social characteristics and data. Although political risk analysis and the insurance market now offer a large number of indicators commonly used by private companies and academic researchers, empirical evidence suggests that their forecast performance is limited (Stosberg, 2005, s. 113). While country risk can be measured more quantitatively, in the case of political risk, in most cases, a purely quantitative approach is not possible. Political events such as revolutions, terrorist attacks, sudden changes in tariffs or expropriation actions are much more difficult to predict. Therefore, human judgment plays a central role in political risk analysis.

The data used in this study were obtained from Political Risk Services / Political Risk Services (PRS Group) and the variables used in scoring are shown in Table 1. Political Risk Scoring is examined by different research institutions under the country risk and is not examined as detailed as the PRS Group company. The reason for choosing this rating is that it is in the form of monthly data.

Table 1. PRS Group Political Risk Scoring

| Category | Component | Score |
|----------|-----------|-------|
|----------|-----------|-------|

| | | |
|---|--------------------------------------|----|
| A | Government Stability | 12 |
| B | Socioeconomic Conditions | 12 |
| C | Yatırım Profili (Investment Profile) | 12 |
| D | Internal Conflict | 12 |
| E | External Conflict | 12 |
| F | Corruption | 6 |
| G | Military in Politics | 6 |
| H | Religious Tensions | 6 |
| I | Law and Order | 6 |
| J | Ethnic Tensions | 6 |
| K | Democratic Accountability | 6 |
| L | Bureaucracy Quality | 4 |

In this system, in which a total of 100 points are distributed according to the importance of the variables, the reliability of the countries increases as the score increases. In other words, countries scoring low in this scoring system have higher political risks. For example, according to the evaluations made in July 2016, the risk scores of various countries were determined as shown in Table 2. Accordingly, the country with the highest score is New Zealand and its score is 88. Switzerland and Canada follow with a total score of 87.5. Somalia is the country with the lowest score. As can be seen from the examples, the countries with the highest political risk are the ones scoring low from this scoring.

When the PRS ratings are compared with the ratings made by international credit rating agencies, it is seen that they are largely similar. The reason for this is that 3 organizations of USA origin, Moody's, S & P's and Fitch, can affect the reports of almost all other companies with the reports they publish.

Table 2. Risk Ratings Comparison Chart

| | PRS | Credendo | | S&P | Moody's | Fitch |
|---------------------|-------------------------|--------------------------------|-------------------------------|------------------------|---------|-------|
| | PRS Group 2016/06 Score | Political Risk Short Term 2020 | Political Risk Long Term 2020 | Credit Ratings 2020/01 | | |
| New Zealand | 88,0 | 1 | 1 | AA | Aa3 | AA |
| Switzerland | 87,5 | 1 | 1 | AAA | Aaa | AAA |
| Canada | 84,0 | 1 | 1 | AAA | Aa2 | AAA |
| U.K. | 87,5 | 1 | 1 | AA | Aa2 | AA- |
| USA | 81,5 | 1 | 1 | AA+ | Ba2 | BBB+ |
| India | 63,0 | 2 | 3 | BBB- | Baa2 | BBB- |
| South Africa | 62,5 | 3 | 4 | BB | Ba1 | BB |
| Russia | 56,0 | 3 | 4 | BBB- | Baa3 | BBB |
| Turkey | 54,5 | 4 | 5 | B+ | B1 | BB- |
| Iraq | 39,5 | 6 | 6 | B- | Caa1 | B- |
| Somali | 32,5 | 7 | 7 | - | - | - |

Source: (Fitch, 2020) (S&P, 2020) (Moody's, 2020) (Credendo, 2020) (PRS, 2020)

According to the risk ratings comparison chart, PRS group, Credendo, S&P's, Moody's and Fitch research companies points are given for selected countries. These countries are chosen to comparison with Turkey's situation around the World. In all examples best points are given to New Zealand, and the worst is Somali, and some research companies did not even pointed this country.

Credit ratings are very important for the economies of developing countries in terms of attracting investors. For example, three different rating agencies made by evaluations of notes given to Turkey, while in the speculative level until 2012. From 2009, in November 2012, then issued a Fitch investment grade from Moody's and considered Fitch in May 2013 as a sub-investment can be made in the middle class. Until January 2017 having made at least one investment grade from all three institutions Turkey, he did not receive a positive note from someone ever since.

4. Political Risk Analysis of Turkey

One of the most important factors that determine the political risk ratings of Turkey is that, its geographical position and proximity to the troubled regions of the World. When possible situations involving political risks of Turkey are analyzed, topics such as terrorism, foreign conflict, democratic accountability come to the fore.

Examples of different situations that affect the country's political risk score are given in Table 3. Dates analysis will be made from Turkey's 2001 financial crisis was initiated after the period. After examining the issues between the years 2001* crisis period from 2002 to 2019 and has been managed by the same government in Turkey has achieved a certain degree of political stability. However, even if the government stability variable was eliminated, the risk curve this time showed ups and downs due to different events.

Turkey's political risk rating by PRS Group are shown on Figure 1. and these ratings causes and case studies are tried to explained on the Table 3.

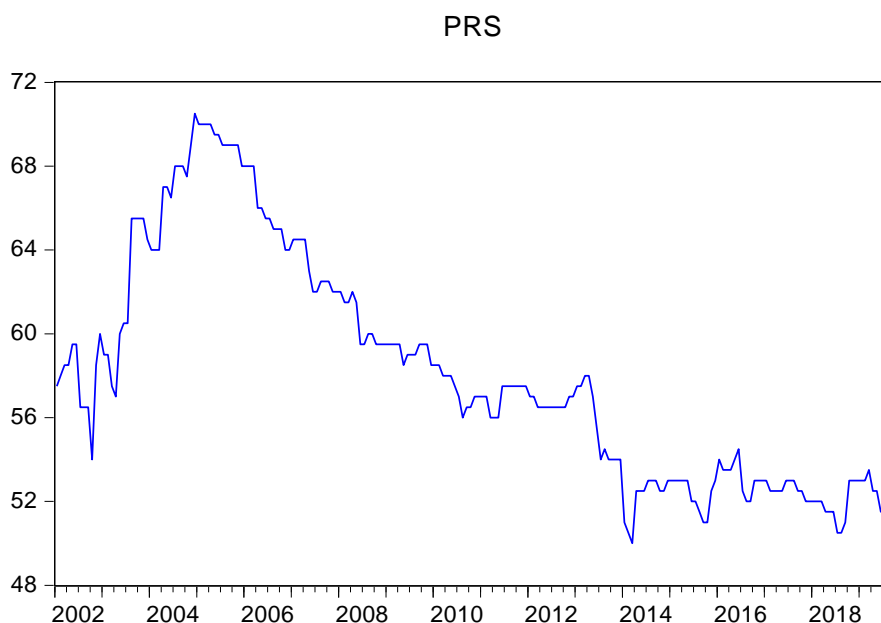


Figure 1. Turkey Political Risk Rating Chart 2002-2019 Source: (PRS Group, 2019)

When Figure 2 is examined, it is determined that 6 different breaks occurred in 17 years. The first is the sudden fall in 2002/10 before the general elections and the sudden rise in the month after the elections. The second break in 2003 / '04 has experienced after the invasion of Turkey's neighbor Iraq by the US. The terrorist attack on the HSBC General Magement Office in the same year caused the third break in 2004/01. The upward trend, which will last for

1 year after this date, will decrease afterwards. The fourth break is in 2014/03 the period when the first election will be made after the Gezi events. And taking the lowest value in the period under study, it was the month when the political risk was rated the highest. The fifth break in 2015/09 coincides with the period when the cabinet could not be established after the election. The sixth break in 2016/09 marks the period after the July 15 coup attempt. The last break was experienced with the exchange rate crisis in 2018/08. As mentioned earlier, the increase in the political risk score on this chart is a positive situation. The increase in score indicates that the risk decreases. The total score of the country is calculated over the total value of 100 points. See Table 1 for the calculation criteria.

Located below exemplify the theory with facts and provisions specified in Turkey over the years, including political risks are detailed in Table 3.

Table 3. Turkey Political Risk Analysis Table 2002-2019

| Turkey's Political Risk Analysis 2002-2019 | | |
|---|---|---|
| | Political and Economic Events | Affected Variables |
| 2002 | General Elections in November, after the 2001 economic crisis | Government Stability Internal Conflict Socioeconomic Conditions Bureaucracy Quality |
| 2003 | The invasion of Turkey's neighbor Iraq by the USA on March, The terrorist attack on the HSBC General Magement Office | External Conflict / International Environment Risk, Geopolitical Risk Terrorism |
| 2004 | Local Elections USA Presidential Elections | Government Stability Internal Conflict Socioeconomic Conditions Bureaucracy Quality |
| 2005 | Perception of Stability Negotiations with the EU | Stabilization Positive Effect |
| 2006 | Attack on the 2nd Chamber of the Council of State Fluctuation in international markets | Terrorism Internal Conflict Law and Order Socioeconomic Conditions |
| 2007 | The Hrant Dink assassination in January E-Memorandum in April, Live bomb attack in Ankara, Ulus, July-General elections October - Constitutional referendum | Terrorism Internal Conflict Law and Order Military in Politics Government Stability |

| | | |
|-------------|---|---|
| 2008 | Cross-border operation to Iraq Russia's intervention in Georgia US Presidential Election | External Conflict Geopolitical Risk External Conflict |
| 2009 | Davos Crisis in January Iran Nuclear Weapons Studies Local elections in March | External Conflict Geopolitical Risk External Factors Government Stability |
| 2010 | Balyoz Coup Investigation Israel's sinking IHH ship Constitutional referendum | Internal Conflict Military in Politics External Conflict Law and Order |
| 2011 | General Elections | Government Stability |
| 2012 | Internal Policy is stable USA Presidential elections | External Factors |
| 2013 | Gezi' Events that started in June Corruption and Bribery operations | Internal Conflict Corruption Law and Order |
| 2014 | Local Elections Presidential Elections | Government Stability Socioeconomic Condition Democratic Accountability Corruption Law and Order |
| 2015 | General elections for June Cabinet cannot be installed Increased terrorist acts Repeating Elections November- Dropping the Russian Warplane | Government Stability Terrorism Internal Conflict External Conflict |
| 2016 | January- Sultanahmet Bomb Attack March- Istiklal Avenue Bomb Attack July 15 Coup Attempt August-Syrian Operation of 'Firat Kalkan' The Killing of Russian Ambassador to Ankara Karlov | Terrorism Military in Politics Internal Conflict External Conflict |
| 2017 | Bomb Attack on Reina on New Year's Eve Diplomacy crisis with the Netherlands Presidential System People's Vote | Terrorism External Factors Government Stability |
| 2018 | June- General Elections and Presidential Elections | Government Stability External Factors |

| | | |
|------|--|--|
| | August-Foreign Exchange Crisis | Socioeconomic Conditions Investment Profile |
| 2019 | Local Elections and Repetition of Elections | Government Stability Law and Order |

Source: Informations on political developments are taken from newspapers and magazines and compiled by the author (BBC News, 2020) (Haberturk, 2020) (NTV Archive, 2019). Affected variables are taken from PRS Group political risk analysis table (PRS Group, 2020)

In Table 3, PRS Group grading method used in variables, Turkey between the years of 2002-2019, examples of which are thought to affect the scoring events were investigated. When case studies are examined, in theory, the issues of government stability, internal conflict and terrorism are mostly encountered. Then comes external factors, geopolitical risk, and the military's role in politics.

5. Conclusion

In today's global business environment, international managers need to constantly monitor and evaluate economic, social and political risks. A change in any of these factors can affect their operations, investment decisions, exposure to risk, or the profitability of companies and organizations. When working or consulting for a multinational company, an international bank or government agency, managers need to be up to date on current events and future trends and risks and opportunities in other markets. One of these information is the country's political risk, past perception and future prospects.

The political risk in international investment stems from a variety of factors that can adversely affect a company's income or complicate its business strategy. These factors include macroeconomic issues such as high interest rates and social issues such as civil unrest. The experiences of the country in the past are also examples for the future. In the period analyzed, exemplifying Turkey's political risk situations and associated with the theory. Efforts should be made to avoid repeating these example situations. These events resulted in higher CDS premiums and falling FDI to Turkey in the international business arena.

Most recent studies in the economic literature have concluded that key investment parameters are influenced by political factors when making managerial decisions such as investment level, investment type and risk premium requirements.

Although the relationship between the volume and nature of FDI and political risk is still empirically controversial, political risk is still considered as an additional risk in the institutional perspective and a factor that reduces growth from the host country perspective. Here again, it makes the state intervention risk, which is one of the main concepts of political risk, the most important factor affecting FDI.

The negative relationship between political risk and FDI has been demonstrated with many examples. While one is increasing, the other is increasing. Based on these results, developing countries can improve their investment climate by creating a quality institutional structure and effectively fighting corruption. Thus, they can establish sound macroeconomic policies that reduce cost, uncertainty and risk. In this case, political risk will decrease, so it can receive more FDI.

The empirical studies conducted in different years for Turkey in particular shows that CDS premia and credit FDI affected by political risk ratings. In this study, the variables used in cases involving political risks in Turkey international institutions ratings were examined by the case. It is determined that the perception of political risk has damaged the country's economy, growth, investment and future. In particular, it will be in the country's best interest to minimize the impact of factors such as government stability, socioeconomic conditions, internal conflict and external conflict. Making policy by paying attention to these ratings affecting investors' decision will benefit the future of the country.

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